

**DECLARATION OF MICHAEL R. BARANOWSKI
ON BEHALF OF AT&T CORP.**

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**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of

Application by Verizon Pennsylvania Inc.,)	
Verizon Long Distance, Verizon Enterprise)	CC Docket No. 01-138
Solutions, Verizon Global Networks Inc.,)	
and Verizon Select Services Inc., For)	
Authorization To Provide In-Region,)	
InterLATA Services In Pennsylvania)	
)	

**DECLARATION OF MICHAEL R. BARANOWSKI
ON BEHALF OF AT&T CORP.**

Based on my personal knowledge and on information learned in the course of my duties, I, Michael R. Baranowski, declare as follows:

1. My name is Michael R. Baranowski. I am Executive Vice President of FTI/Klick, Kent & Allen, Inc., a subsidiary of FTI Consulting, Inc. ("FTI/KKA"). FTI/KKA is an economic and financial consulting firm with offices at 66 Canal Center Plaza, Suite 670, Alexandria VA, 22314. In that position, I conduct economic and cost analysis for a variety of clients. Since 1996, I have been directly and continuously involved in interconnection agreement arbitrations and other network element rate proceedings before state public utility commissions. In that regard, I am intimately familiar with the cost models submitted by Verizon and other incumbent local exchange carriers. I am submitting this declaration at the request of AT&T.

I. PURPOSE AND OVERVIEW OF TESTIMONY.

2. The purpose of my testimony is to explain why the recurring and non-recurring unbundled network element (“UNE”) rates upon which Verizon’s Section 271 Application is based are not remotely cost-based and violate numerous fundamental TELRIC principles.

3. What separates this Section 271 proceeding from any other Section 271 proceeding in which I have provided testimony is that the applicant (Verizon) has conceded that its Pennsylvania rates were not developed through the application of TELRIC principles. *Presentation of Bell Atlantic—New Jersey, Inc. Augmenting the Existing Record*, State of New Jersey, Board of Public Utilities, Docket No. TO00060356, pp. 10-11 (“were not based upon new cost studies, . . . but were instead the product of the give and take associated with settlement discussions involving multiple issues”). Yet, Verizon now claims that the rates in its Pennsylvania Section 271 applications are TELRIC-compliant. Tellingly, however, Verizon offers no direct evidence in support of these assertions. Verizon apparently has not even filed a pricing affidavit with its application to explain the derivation of its proposed rates. My analysis of the UNE rates in Verizon’s Section 271 application confirms that Verizon was correct the first time – that its Pennsylvania UNE rates are “arbitrary, capricious and unsupported by any record evidence,” and that they “are not TELRIC compliant.” *Id.*

4. My conclusions are based on my review of the hard copy materials provided by Verizon in support of its Section 271 application and my involvement in several UNE pricing proceedings before the PaPUC, including the so-called *MFS III* and *Global* proceedings. As an active participant in those proceeding on behalf of AT&T (and, in the *MFS III* proceeding, MCI/Worldcom), I have had access to both machine-readable and hard copy versions of

Verizon's testimony and cost study materials, and have observed first hand the methods employed by Verizon to artificially inflate its proposed UNE costs.

II. BACKGROUND

5. The UNE rates that are currently in effect in Pennsylvania – and upon which Verizon's Pennsylvania Section 271 application rely – were not the result of any cost proceeding or TELRIC pricing model. Rather, those rates are the result of a proceeding in which the Commission selected rates from two settlement proposals that encompassed a wide variety of disputed issues, the majority of which did not involve UNE rates at all. *See Nextlink Pennsylvania, Inc.*, 196 P.U.R.^{4th} 172, 184 (1999) (“*Global Order*”).

6. The *Global Order* was the culmination of a series of proceedings that were intended to establish rates for Verizon's unbundled network elements. The first such case commenced in 1996 when AT&T and Verizon (then Bell Atlantic) were unable to reach agreement on terms for the provision of Verizon's UNEs to AT&T in Pennsylvania. Much of the disagreement between AT&T and Verizon in that initial proceeding involved the cost studies relied upon by Verizon to support its proposed rates for UNEs. In its final decision, the PaPUC ruled that Verizon's cost data violated TELRIC standards in a number of critical respects, and rejected Verizon's proposed rates as too high. *See Petition of AT&T Communications Of Pennsylvania, Inc. For Arbitration Of Its Interconnection Request To Bell Atlantic-PA, Inc.*, Docket No. A-310125F0002 (Interconnection Arbitration), Opinion at Order, November 25, 1996. Instead, the PaPUC adopted as an interim remedy certain default rates calculated by the FCC in its *Local Competition Order*. *Id.* at 16-19.

7. In the wake of its decision in the AT&T arbitration, the PaPUC opened a new proceeding to establish permanent rates. *See Application of MFS Intelenet of Pennsylvania, Inc.* PUC Docket No. A-3110203F0002 (Phase III) and consolidated cases (Nov. 1996) (“*MFS III*”). The most significant disputes between Verizon and the other parties (including AT&T) in that proceeding remained the inputs and assumptions underlying Verizon’s cost models. In that proceeding, Verizon argued that TELRIC in fact allows local exchange carriers (“LECs”) to recover “actual” costs, and submitted studies whose inputs and assumptions essentially reflected Verizon’s embedded network. AT&T, for its part, submitted evidence demonstrating that Verizon’s costing methodology was inconsistent with the Commission’s TELRIC methodology.

8. On April 10, 1997, the PaPUC issued an interim order in the *MFS III* proceeding. In that order, the PaPUC acknowledged that forward-looking cost principles governed the case, and further professed to embrace the Commission’s implementation of those cost principles as stated in the Commission’s *Local Competition Order*. Nevertheless, the PaPUC adopted Verizon’s embedded cost UNE pricing methodology, along with most of the specific input values proposed by Verizon. However, the PaPUC did not set specific rates for Verizon’s network elements in that Interim Order, but instead directed Verizon to calculate rates based on the inputs and assumptions approved in that Order.

9. Between April and June 1997, Verizon, AT&T, MCI and other parties filed schedules of specific rates purporting to comply with the PaPUC’s interim order. On August 7, 1997, PaPUC issued its Final Opinion and Order in *MFS III*. *See Application of MFS Intelenet of Pennsylvania, et al.*, Final Opinion and Order, Docket Nos. A-310203F0002, *et al.* (Pa. PUC Aug. 7, 1997) (“*MFS Phase III Order*”). By a 3-to-2 vote, PaPUC reaffirmed all but one of the findings in the PaPUC’s Interim Order. The PaPUC frankly conceded, however, that the UNE

rates set by the Interim Order were too high to allow UNE-based residential entry by competitors. *See id.* at 12; *see also* Motion of Chairman John M. Quain at 3.

10. MCI filed suit in the U.S. District Court for the Middle District of Pennsylvania challenging the PaPUC's decision in its arbitration with Verizon, including the *MFS III* rates, which had been incorporated into the final interconnection agreement. AT&T was granted leave to intervene as a party plaintiff. Resolving the parties' cross-motions for summary judgment, the District Court granted summary judgment for AT&T and MCI, finding that, by the PaPUC's own admission, the rates set in the *MFS Phase III Order* were not established in accordance with the Commission's TELRIC pricing rules. *MCI Telecommunication Corp. v. Bell Atlantic-Pennsylvania, Inc.*, case No. 1-97-CV-1857 (M.D. Pa. June 30, 2000), slip op. at 10-13. The Court remanded the cases to the PaPUC for reconsideration in light of the Commission's pricing rules. That decision is now on appeal to the U.S. Court of Appeals for the Third Circuit, and it is my understanding that the PaPUC has not acted on the district court's remand.

11. In July 1998, while the District Court appeals were pending, the PaPUC began, *sua sponte*, a comprehensive investigation of Verizon's UNE rates. However, that investigation, along with a number of other proceedings pending before the PaPUC, was halted when the PaPUC commenced a "global settlement conference" on various disputed telecommunications issues. When that conference failed to achieve a negotiated resolution of those issues, two separate groups, one including AT&T and the other led by Verizon, petitioned the PaPUC to resolve the pending proceedings in accordance with the terms of each group's settlement proposals. *See Global Order* at 5-6. Among the issues proposed for resolution in those petitions was Verizon's UNE rates.

12. After conducting hearings on each of those proposals, the PaPUC held that the “empirical evidence” indicated that the *MFS III* rates were “not set at the TELRIC level.” *Global Order* at 69. In particular, the PaPUC found that certain costing assumptions used in Verizon’s model overstated the cost of Next Generation Digital Loop Carrier equipment. *Id.* at 69-70. The PaPUC also found that both the cost of capital and fill factor inputs that had been used to develop the *MFS III* rates also violated TELRIC principles, and established new values for each of those inputs. *Id.* at 73-76. Despite these findings, the PaPUC did not utilize these new values and assumptions to establish the new rates for basic unbundled elements, including loops, ports, and switch usage. In fact, the PaPUC did not use any model at all.¹ Rather, the PaPUC adopted a new set of UNE rates derived from the competing settlement proposals.

13. The PaPUC justified its *Global Order* rates by looking back to a series of “scenarios” running Verizon’s cost studies with different input assumptions that the PaPUC had required the parties to submit during the *MFS III* proceedings. The PaPUC identified one such scenario – “Scenario 9” – that produced loop rates that were close to the settlement rates. The Scenario 9 assumptions and input values differed from those of the *MFS III* rates (which the federal district court had already rejected) in only two respects. *Id.* at 73-74. Because of the “remarkable similarity” between the weighted 2-wire average loop rates proposed in the settlement petitions and that from Scenario 9, the PaPUC approved the settlement rates. *Id.* at 76-77 (“although not identical to the Scenario 9 Loop rates by Density Cell [*i.e.*, the four rate zones of the state], [the settlement rates] are just and reasonable when the statewide average loop

¹ Significantly, Verizon did not introduce any cost study to support the rates it proposed in its settlement petition. In contrast, MCI introduced the results of the Hatfield Model in support of its rate proposal. *See Global Order* at 70. And I submitted testimony on behalf of AT&T demonstrating that the UNE rate proposals ultimately adopted by the PaPUC were far in excess of TELRIC levels.

rates are taken into consideration.”). The PaPUC thus directed Verizon to amend its tariff to reflect the settlement rates. *Id.* at 83.

14. As I explain below, that comparison demonstrating the similarity of the rates set by the *Global Order* to those in *MFS III* only proves that the *Global Order* rates – on which Verizon’s application is based – are not TELRIC based. Indeed, even setting aside the fact that the PaPUC and a district court have already found those rates to be based on cost studies that violate TELRIC principles, there are numerous specific flaws in Verizon’s *MFS III* cost models that plainly violate even the most basic TELRIC standards.

III. VERIZON’S PENNSYLVANIA UNE RATES ARE NOT BASED ON A RIGOROUS APPLICATION OF TELRIC PRINCIPLES

15. The UNE rates that Verizon appears to rely on in its Pennsylvania Section 271 application are based on those adopted by the PaPUC in the *Global Order*. As I explained in ¶ II, *supra*, even Verizon has stated that the *Global Order* rates violate TELRIC.

16. Nevertheless, Verizon now claims that the *Global Order* rates comply with TELRIC and urges the Commission to take its word on that point – indeed Verizon offers no specific evidence or testimony in support of that assertion. Rather, Verizon simply points out that the PaPUC has examined those rates and found them to comply with TELRIC.

17. As explained in Part II, *supra*, however, the PaPUC never seriously examined the *Global Order* rates. Instead, the PaPUC simply attempted to justify its *Global Order* rates by pointing out that the rates in the *Global Order* are very similar to those produced by “Scenario 9” of the *MFS III* cost studies. But that comparison only proves that the *Global Order* rates – on which Verizon’s Section 271 application relies – are not remotely cost based. As noted above

the District Court for the Middle District of Pennsylvania remanded the PaPUC's *MFS Phase III Order* back to the PaPUC in part because the *MFS III* cost studies did not comply with this Commission's TELRIC methodology. In fact, Verizon's *MFS III* cost studies contain numerous fundamental TELRIC errors.

IV. VERIZON'S *MFS III* COST STUDIES VIOLATE NUMEROUS TELRIC PRINCIPLES.

18. The *MFS III* cost models violate fundamental TELRIC principles. In this section, I demonstrate that (1) Verizon's *MFS III* cost studies largely implement an impermissible "reproduction" approach to network design rather than the forward-looking "replacement" approach to network design required by the Commission's TELRIC rules, and (2) Verizon's *MFS III* costs studies fail to comply with numerous other basic TELRIC principles. Each of the problems that I identify causes Verizon's UNE estimates to be significantly inflated.

A. Verizon Concedes That The *MFS III* Cost Studies Are Based On Existing Architecture And Technology Rather Than On A Forward-Looking Architecture And Technology As Required By The Commission's Rules.

19. The Commission's rules require that the "total long-run incremental cost [TELRIC] of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. §51.505(b)(1). As the Commission has recognized, this requires the "replacement cost" estimation methodology that economists and regulators have long recognized best replicates competitive market outcomes. Under that approach, the cost estimator designs the most efficient network capable of delivering the relevant functionalities without regard to the design, architecture and technologies employed in the existing network.

20. By contrast, Verizon has conceded that the *MFS III* cost studies are based on “what it would actually cost to replicate the existing network.” Verizon’s Appellant’s Brief, *MCI Telecom. Corp. et al. v. Verizon Pennsylvania Inc., et al.*, 3rd Cir., No. 00-2258 (filed Dec. 20, 2000), pp.38-39. Thus, the *MFS III* cost study violates the core TELRIC requirement that costs be based on carrier’s replacement costs, not on reproduction costs.

B. The Inclusion Of Verizon’s Broadband Costs In Computing Its UNE Rates Violates TELRIC.

21. The *MFS III* cost studies improperly include the cost of a mix of 100 percent fiber network installed by Verizon in anticipation of someday providing “broadband” (video) service in its UNE loop rates. Verizon has specifically conceded this fact, noting that its loop cost studies assumed that 20 percent of all loops (the lines that link residences and businesses with the telephone companies local switches) would reflect the more costly 100 percent fiber cable network that can carry broadband services like video, even though broadband capable facilities are unnecessary to provide the telephone services that the Act addresses and that competing carriers seek to provide with Verizon’s facilities. Thus, carriers that purchase voice-grade narrowband UNE loops from Verizon-Pennsylvania are effectively subsidizing Verizon’s broadband infrastructure, which plainly violates TELRIC standards.

22. The Chairman of the PaPUC essentially conceded this as fact, stating that it was the Commission’s “goal” in establishing UNE rates “to provide Bell Atlantic-Pennsylvania with an adequate revenue stream” in order to fund its broadband network deployment. Motion of Chairman John M. Quain, July 7, 1997, at 1.

23. By including the costs of broadband investment in its UNE loop rates, the *MFS III* cost studies violate TELRIC. The Commission’s TELRIC rules specifically limit the costs of an

element to those “that are directly attributable to, or reasonably identified as incremental to,” the element. 47 C.F.R. § 51.505(b)(1).² To be attributed to a network element, a cost must be “causally-related to the network element being provided” in the sense of being necessary to provide it. *Local Competition Order* at ¶ 691 (“Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them”).

24. One reason for this “causation” standard is to ensure local exchange carriers do not attempt subsidize ventures that are unrelated to the provision of voice grade access. *See* 47 C.F.R. § 51.505(d)(4). But that is exactly what the PaPUC has allowed Verizon to do in Pennsylvania.³ Indeed, narrowband (voice-grade) service can be provided without the more expensive broadband capabilities and extra costs of the fiber cable and other assets used to provide broadband service.

25. I understand that Verizon and PaPUC have attempted to defend the inclusion of broadband facilities in UNE loop rates on the grounds that, in some instances, broadband facilities are less expensive than narrowband facilities. But that justification cannot withstand scrutiny. The record in the *MFS III* proceeding clearly established that the inclusion of

² Similarly, the costs of an element may not include “[r]evenues to subsidize other services,” including “revenues associated with elements or telecommunications service offerings other than the element for which a rate is being established.” 47 C.F.R. § 51.505(d)(4).

³ Significantly, when the PaPUC approved Verizon’s proposal for a broadband deployment plan, it specifically prohibited Verizon from allocating the costs of that network deployment to voice customers. Opinion and Order, *Bell Atlantic-Pennsylvania, Inc.’s Petition and Plan for Alternative Form of Regulation Under Chaoter 30*, PaPUC Docket No. P-00930715, 1994 Pa PUC LEXIS 142, 193 (June 28, 1994). The UNE cost methodology utilized by Verizon,

broadband services significantly *increased* UNE loop rates by (1) including fiber cable in the loop even where copper facilities would be more cost-effective for providing narrowband telephony services, and (2) shortening the depreciation lives for copper loop facilities and current generation digital switches and circuit equipment. The *net* effect of these two factors inflates the *overall* loop costs in Pennsylvania by about \$1.00 per loop.

26. Even the PAPUC's Chairman, John Quain, effectively admitted that that allowing Verizon to recover broadband investment through loop rates was not based on TELRIC principles. Rather, Chair Quain explained that the majority had decided to "balance" the competitive policies of the 1996 Act against the PaPUC's desire to promote the deployment of broadband (video) technology in Pennsylvania by providing Verizon "with an adequate revenue stream to meet its obligations to deploy" such technology. Motion of Chairman John M. Quain at 1 (July 10, 1997).

C. All Of The MFS III Rates Are Inflated by Depreciation And Repair And Maintenance Approaches That Violate Basic TELRIC Principles And That Inflate Rates For All UNEs.

27. *Depreciation.* The radically shortened depreciation lives proposed by Verizon and uncritically accepted by the PaPUC plainly violate TELRIC principles. Depreciation lives are intended to provide, on an annual basis, a recovery of the cost of replacing assets that are expected to wear out or become obsolete over time. Shorter depreciation lives mean higher network element rates, because a larger share of the investment in network equipment may be recovered from ratepayers as a depreciation expense each year.

however, results in precisely the same improper cost allocation that the PaPUC purported to prohibit in that 1994 order.

28. Verizon's depreciation lives are not remotely TELRIC-compatible because they are not economic depreciation lives, as required by the Commission's rules. *See* 47 C.F.R. § 51.505(b)(3) ("The depreciation rates used in calculating forward-looking economic costs elements shall be economic depreciation rates"). This point is best illustrated by comparing Verizon's Pennsylvania rates to those approved by the Commission and those in other states that have obtained Section 271 approval.

29. In Table 1 (below), I compare a sample of capital depreciation lives for certain UNE components used by Verizon's cost studies to several benchmarks. First, I compare Verizon's capital depreciation lives to those approved by the Commission for regulatory use. This comparison shows that for many significant pieces of capital equipment (including cable), Verizon's depreciation lives are as little as one half of those approved by the Commission. I also compare Verizon's Pennsylvania depreciation lives to those adopted in other Section 271 approved states for which depreciation rates are available. Once again, the depreciation lives used by Verizon in Pennsylvania are not even close to those used by other entities.

Table 1. Comparison of Depreciation Lives for Major Asset Categories Between Verizon Pennsylvania and Other Comparable States

Account	Verizon-PA UNE	FCC Permitted Range	Texas UNE	Kansas UNE	Mass. UNE
ESS Digital	9.0	16.0-18.0	14.0	14.5	15.0
Circuit Digital	10.0	11.0-13.0	10.2	11.0	11.0
Aerial Cable	16.0	20.0-26.0	20.0	20.0	22.0
Under-ground Metallic Cable	16.0	25.0-30.0	25.0	25.0	25.0
Buried Metallic Cable	16.0	20.0-26.0	22.0	20.0	23.0
Aerial Fiber Cable	20.0	25.0-30.0	17.3	25.0	25.0

30. Given this comparison, it should not be surprising that, at the time that Verizon made-up its Pennsylvania depreciation lives, they were significantly shorter than the depreciation lives used by any state Commission in Verizon's region, and have been since rejected by regulators in several of Verizon's other states. In Delaware, for example, the Hearing Examiner for the Delaware Public Service Commission rejected these same depreciation lives, noting that "the depreciation lives proposed by [Verizon in Delaware] . . . are too short and should be rejected."⁴ And the Maryland Public Service Commission, in adopting the FCC's lives explained "we note the difficulty in reviewing and verifying the shortened lives advocated by

⁴ *In the Matter of the Application of Bell Atlantic-Delaware, Inc. For Approval of Its Statement of Terms and Conditions Under Section 252(f) of the Telecommunications Act of 1996*, PSC

[Verizon], while the relatively recent FCC prescribed depreciation rates have undergone scrutiny and have been accepted by the FCC as well as other jurisdictions.”⁵

31. The impact of Verizon’s use of unusually short depreciation lives on Verizon’s Pennsylvania UNE rates is substantial given the general significance of depreciation lives to cost estimates and the enormous deviation of Verizon’s Pennsylvania lives from reasonable estimates of true economic lives.

32. *Repair and Maintenance.* Verizon’s repair and maintenance factor violates TELRIC in two ways. First, Verizon’s repair and maintenance factors are based on the historical (or embedded) costs of Verizon’s network – a direct violation of TELRIC’s forward-looking methodology. Indeed, Verizon computed its historical repair and maintenance factor by arbitrarily adding 20 percent to its historical repair and maintenance costs. Second, even if (contrary to fact) TELRIC standards allowed repair and maintenance factors to be based on those of Verizon’s embedded network, there is no reason to believe (and Verizon provides no such reason) that forward-looking repair and maintenance factors would be 20 percent *higher* than those in Verizon’s old embedded network. Rather, forward-looking loop repair and maintenance costs should be *lower* in a TELRIC-compatible network because those costs would be based on the assumed use of all new cables, and would not include the obsolete and worn out cables in Verizon’s existing network. Indeed, that is one reason why an Administrative Law Judge in New York recently rejected Verizon’s repair and maintenance costs. *See Proceeding on the Motion of the Commission to Examine New York Telephone Company’s Rates For Unbundled*

Docket No. 96-324; Findings and Recommendations of the Hearing Examiners, April 7, 1997 at 41.

⁵ Maryland Public Service Commission Order No. 73707, September 22, 1997 at 42.

Network Elements, Recommended Decision on Module 3 Issues, Case 98-C-1357, at 57-58 (May 16, 2001) (“*New York Re-Examination Decision*”).

D. Verizon’s *MFS III* Loop Rates Are Inflated By Numerous Additional TELRIC Violations.

33. *LCAM Cost Model And Fill Factors.* The LCAM loop cost model – which is used to compute loop rates in the *MFS III* cost studies – severely overstates Verizon’s investment in distribution cable. As a general matter, a carrier’s investment in distribution cable must be adjusted upwards to account for the necessary additional capacity that the carrier will need to account for growth and to ensure that its customers receive reliable service. Accordingly, it is appropriate for ILEC’s to adjust its distribution cable investments upward using a fill factor. But for reasons that Verizon has been unable to rationally explain, Verizon also increases its *distribution* cable investments (a second time) in its the LCAM cost model by a utilization factor for copper *feeder* cable. Thus, Verizon’s cost model effectively double-counts the need for excess capacity in its distribution cables, and the second upward adjustment in that double-counting mechanism is not even related to distribution cable but is instead based on the need for excess capacity for feeder cable.⁶

34. As a result of this well documented flaw in Verizon’s LCAM cost model for Pennsylvania, the 2-wire analog loop costs in Verizon’s initial *MFS III* submission is overstated by approximately \$1.00 per line per month.

⁶ Notably, this double counting often resulted in the provisioning of the lines-per-living-unit that were well above Verizon’s stated maximum study distribution design criteria of three lines per living unit. And although Verizon at the time steadfastly argued the validity of this added step in the LCAM model, more recent versions of the LCAM that I have seen in other jurisdictions have been corrected and no longer include this extra step.

35. *Digital Loop Carrier.* The *MFS III* cost studies overstate the costs of Next Generation Digital Loop Carrier (“NGDLC”) equipment. When the initial *MFS III* cost studies were performed in 1997, Verizon’s cost model assumed the use of what it called “Next Generation” Digital Loop Carrier equipment. However, because Verizon claimed, in 1997, to be unable to establish prices for NGDLC equipment that was capable of being unbundled for the provisioning of UNE’s, Verizon instead developed a surrogate price for NGDLC that was based in part on the prices of the older, more expensive, universal digital loop carrier equipment.

36. Today, however, there is no excuse for using the inflated costs of universal digital loop carrier equipment as a surrogate for NGDLC. Currently available DLC systems with integrated interfaces readily provide for unbundling and are widely available at prices that are firmly established. Thus, Verizon’s continued use of the more expensive surrogate universal digital loop carrier equipment prices is no longer necessary and plainly overstates Verizon’s Pennsylvania UNE rates.

37. The PaPUC itself has recognized this problem. In the *Global Order*, the PaPUC found that Verizon’s own internal documents concerning the implementation of NGDLC proved that costing assumption Verizon had used in the MFS-III proceeding “is no longer true.”⁷ And that the evidence showed that “in all instances” NGDLC “is significantly less expensive” than that Verizon had assumed in its calculations.⁸ Notwithstanding this finding, however, Verizon

⁷ *Global Order*, at 70.

⁸ *Id.*

has not corrected this assumption in its *MFS III* model, and the resulting inflation of costs continues to be reflected in its rates.⁹

E. Verizon's Switching Rates Are Not Based On Forward-Looking Least Cost Switch Prices And, As A Result, Are Significantly Overstated.

38. *Switch Discounts.* Forward-looking, TELRIC-compatible, cost studies must assume a “scorched-node” environment where the only elements of the LEC’s embedded network are the locations of existing wire centers. *Local Competition Order* ¶ 685. All assets necessary to service demand for telecommunications in the Verizon Pennsylvania service territory would therefore have to be newly purchased. Thus, the applicable switch discounts should be those that are available for new switching equipment.

39. The *MFS III* cost models violate this fundamental principle by computing switch discounts based on attributable growth – the volume and type of switches that would be needed to expand Verizon’s *existing* network – rather than on the larger discounts that are available to Verizon for new equipment.¹⁰ Verizon itself concedes that large buyers of new switching equipment can obtain much deeper discounts from vendors’ “standard” or “retail” prices for new

⁹ In the recent proceeding before the PaPUC that resulted in the May 24, 2001 *Interim Order*, Verizon’s cost witness admitted that he had not taken the *Global Order*’s finding concerning NGDLC into account in calculating the UNE rates Verizon had proposed in that proceeding. PaPUC Docket No. R-00005261, November 29, 2000 Transcript at 470-71 (cross-examination of Gary Sanford).

¹⁰ In its cost study Verizon repriced its *entire* switching capacity as if its entire inventory of switches were repurchased at the outset of the study period, but most were purchased at add-on discounts, not new equipment discounts.

equipment than for “add-on” equipment – primarily “line cards” – that can be used to upgrade the capacity of existing switching equipment as demand increases.¹¹

40. Verizon and the PaPUC have attempted to defend the use of attributable growth discounts on the ground that Verizon, having recently replaced all of its analog switches with digital models, expects to buy little new equipment in the next five or so years. But the actual costs required by the *Local Competition Order* are the costs that an efficient firm would actually incur *in the long run* – the “LR” in TELRIC – not the next few years or any other short run period. According to the Commission, the “long run” is the period in which “all of the firm’s present contracts will have run out, its present plant and equipment will have been worn out or rendered obsolete and will therefore need replacement,” and “all of a firm’s costs” thus have “become variable or avoidable.” *Local Competition Order* ¶ 677 & n.1682; *id.* ¶¶ 691-92. Hence, the long run time horizon assumes a firm that is free to choose assets that are optimally sized and configured, unfettered by the legacy of past fixed investments. *See Bell Atlantic-Delaware*, 80 F.Supp.2d at 237-38. In the long run, a firm can replace its existing switches with new switches that are optimally sized to qualify for new equipment discounts.

41. Given this fundamental TELRIC error, it is not surprising that other state regulators in the mid-Atlantic have rejected Verizon’s short-run approach to estimating switching costs. *See Order*, Case No. PUC970005, at 11 (Va. SCC May 22, 1998) at 11; *Order*, Case No. 8731, at 46-49 (Md. PSC Sept. 22, 1997); Findings and Recommendations of Hearing Examiners, PSC Docket No. 96-324, ¶¶ 135-37 (De. PSC Apr. 7, 1997), *aff’d*, *Order No. 4542*,

¹¹ There is no question that in reality Verizon receives the larger discounts for new equipment: nearly all of its existing switches are digital equipment, purchased within the past few years at the deeper discounts available for purchases of new equipment. *See, e.g., Bell Atlantic Delaware v. McMahan*, 80 F.Supp.2d 218, 237-39 (D.Del. 2000).

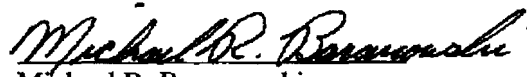
at ¶ 33 (De. PSC July 8, 1997), *aff'd*, *Bell Atlantic-Delaware*, 80 F.Supp.2d at 238-39 (holding that Verizon's analysis of switch discounts was "deficient in that it does not reflect a long-run approach, but rather a series of short-run cost estimates").

V. CONCLUSION

42. Verizon's Pennsylvania UNE rates are not remotely cost-based and violate numerous TELRIC principles.

VERIFICATION PAGE

I, Michael R. Baranowski, declare under penalty of perjury that the foregoing is true and correct.


Michael R. Baranowski

Executed on July 11, 2001.

**Before the
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Application by Verizon Pennsylvania Inc.,)	
Verizon Long Distance, Verizon Enterprise)	
Solutions, Verizon Global Networks Inc.,)	CC Docket No. 01-138
and Verizon Select Services Inc., For)	
Authorization To Provide In-Region,)	
InterLATA Services In Pennsylvania)	
)	

**DECLARATION OF MICHAEL J. NOLEN
ON BEHALF OF AT&T CORP.**

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Application by Verizon Pennsylvania)
Inc., Verizon Long Distance, Verizon)
Enterprise Solutions, Verizon Global)
Networks Inc., and Verizon Select)
Services Inc., for Authorization to)
Provide In-Region, InterLATA Services)
in Pennsylvania)

CC Docket No. 01-138

DECLARATION OF MICHAEL J. NOLEN

1. My name is Michael J. Nolen and I am a citizen of the Commonwealth of Pennsylvania. I am over the age of twenty-one (21). The facts recited herein are true and accurate and based upon my personal knowledge.

2. I reside in an area of Pennsylvania where Verizon Pennsylvania Inc. ("VZ-PA") is the incumbent local exchange carrier, and obtain my residential local exchange service from that company.

3. On July 2 and then again on July 5, 2001, I made several telephone calls to VZ-PA to inquire about obtaining a Digital Subscriber Line ("DSL") at my residence. I made the calls to VZ-PA's Residence Sales and Service Center, using the customer service number that is provided on my VZ-PA monthly telephone bill.

4. I was told by VZ-PA's customer service representatives that I was eligible for a promotional offer through which, if I entered into a year-long commitment, I would obtain what was described as "enhanced" DSL service from

representative that I had that option, and that, in fact, I could use any independent ISP I wished in conjunction with DSL from Verizon.

8. I was also told that if I used an independent ISP, Verizon would still charge me the monthly rate I described above. That is, if I used an ISP other than Verizon, but still obtained the DSL line from Verizon, Verizon would charge me \$49.95 per month and send me a separate bill directly to me for this charge. This would be in addition to whatever the independent ISP charged for its services, which would be billed directly and separately to me by that ISP.

8. The undersigned hereby declares under penalty of perjury that the foregoing is true and correct.

Dated: July 9, 2001


Michael J. Nolen

Verizon for \$49.95 per month, with no "up front" charges. At this monthly rate, I would obtain both a DSL line in my home and Internet service from VZ-PA, as well as e-mail addresses, web space and a free camera for my personal computer. I was told that the only other charges normally applicable to obtaining the DSL line and Internet service from VZ-PA were a \$50 connection charge, which would be waived as part of the promotion, and a \$50 equipment charge for an upgraded modem. I was told that, under the promotion, the modem was essentially free, since VZ-PA would not bill me for the first month of service, i.e. the \$50 charge would be offset by the free month of service.

5. When I asked how I would be billed for this service, VZ-PA's customer service representative told me I could charge the service to a credit card, or simply be charged on my monthly telephone bill. The representative stated that most customers opt to have the charge placed on their telephone bill.

6. The VZ-PA customer service representatives with whom I spoke handled all of my inquiries concerning DSL service, and were prepared to complete a service order for Verizon's DSL service. At no time was I transferred to any affiliate of VZ-PA, such as Verizon Advanced Data Inc. or Verizon On-Line, or told that one of these affiliates, rather than VZ-PA, was responsible for handling all inquiries or orders regarding DSL service.

7. I also asked the customer service representatives whether I could still obtain DSL through VZ-PA if I wanted to use an Internet Service Provider ("ISP") other than Verizon for Internet service. I was told by VZ-PA's